

Securities and Exchange Commission

Office of Inspector General

During the first half of fiscal year 2006, the Office of Inspector General assisted the Commission in its efforts to:

- Prevent workplace violence,
- Improve oversight of disgorgements and penalties,
- Enhance the integrity of the Commission and its staff by investigating allegations of misconduct,
- Ensure appropriate legal review of settlement agreements with employees,
- Enhance the clearance process for separating employees,
- Strengthen controls over use of the Commission shuttle bus, and
- Assure the effectiveness of field office administrative controls.

Executive Summary

During this period (October 1, 2005 to March 31, 2006), the Office of Inspector General (Office) issued two audit reports and four investigative memoranda on management issues. These evaluations focused on oversight of disgorgements and penalties; administrative controls in the Pacific Regional Office (PRO); the clearance process in the PRO; the Commission shuttle bus; legal review of settlement agreements; and the workplace violence prevention program. This work is described in more detail in the Audit Program section below.

Nine investigations were closed during the period. Five subjects were referred to the Department of Justice, which declined prosecution of these subjects. Seven subjects were referred to Commission management. Management directed one subject to cease outside employment, while management decided to take no action for another subject. One subject referred during the prior semi-annual period was demoted to a non-supervisory position; another subject referred during the prior period was suspended for five days and required to attend anger management training. Seven subjects referred during this period and the prior semi-annual period are awaiting disposition. The Investigative Program section below describes the significant cases closed during the period.

Information technology (IT) management had been previously reported as a significant problem. During this period, the Commission continued to improve its IT management, but significant weaknesses remain. We intend to maintain our audit focus in this important area.

An audit completed in a prior period found that Commission financial management controls for fiscal year 2002 were effective in all material respects except for controls over property accountability, accounting and control of disgorgements, information system and security program controls, and the Disgorgement and Penalties Tracking System. We reported these exceptions, taken together, as a significant problem.

The Government Accountability Office (GAO) identified similar weaknesses in its audits of the Commission's fiscal years 2004 and 2005 financial statements (except for property accountability - the value of the property account balance was below the materiality threshold). The Commission intends to complete corrective actions to address the weaknesses in financial management controls by the end of fiscal year 2006.

No management decisions were revised during the period. The Office of Inspector General agrees with all significant management decisions regarding audit recommendations.

Audit Program

The Office issued two audit reports and four investigative reports on management issues during the reporting period. These documents contained a total of 15 recommendations,

which are further summarized below. Management generally concurred with the recommendations, and in many cases took corrective actions during the evaluations.

OVERSIGHT OF DISGORGEMENTS AND PENALITIES (AUDIT 403)

We reviewed Commission oversight of disgorgement and penalty payments from securities law violators, and the recording of payment information. Generally, for the 29 actions we sampled, disgorgements and penalties ordered were paid timely, and the related supporting documentation was accurate.

We recommended that the Division of Enforcement and the Office of Financial Management continue to address data limitations in the Case Activity Tracking System (CATS) and continue development of a system to allow electronic access to case documentation. Other recommendations included recording accurate payment due dates in CATS, making Enforcement's collections unit responsible for additional collections when feasible, and encouraging wire payments or use of a lockbox for payments by check.

PACIFIC REGIONAL OFFICE (AUDIT 414)

We reviewed selected financial and administrative controls in the Pacific Regional Office in Los Angeles, CA (PRO). During the audit, no material weaknesses in the PRO's controls came to our attention. We informally discussed several non-material control weaknesses with PRO management, which agreed to implement corrective actions.

PRO EMPLOYEE CLEARANCE PROCESS (G-432)

During an investigation involving the Pacific Regional Office, we learned that the PRO did not have adequate clearance procedures for separating employees. We made recommendations to improve clearance procedures. These related to the timely and proper completion of the employee clearance form, and the timely return and cancellation of government-issued travel charge cards and passports.

COMMISSION SHUTTLE BUS (G-435)

During an investigation, we identified several concerns regarding the passenger logs for the shuttle bus between Commission headquarters (Station Place) and the Operations Center. These included missing logs, logs without starting dates or times or the driver's name, multiple dates recorded on the same log sheet, and illegible signatures by passengers and drivers. In addition, we found that contrary to Commission policy, at least ten Commission employees appeared to be using the shuttle bus for daily commuting to work at the Operations Center.

We recommended that the Office of Administrative Services (OAS) develop improved procedures for shuttle logs, update and publicize the shuttle bus policies and procedures,

and take steps to enforce these policies and procedures (*e.g.*, by regularly reviewing the shuttle logs).

LEGAL REVIEW OF SETTLEMENT AGREEMENTS (PI-05-26)

During a preliminary inquiry, we learned of a settlement agreement entered into by the Office of Human Resources (OHR) to resolve an administrative grievance. The Office of General Counsel (OGC) did not review the proposed settlement agreement.

To ensure proper consideration of legal issues affecting settlements, we recommended that OHR and OGC develop policies and procedures regarding OGC's role in settlement negotiations and agreements.

WORKPLACE VIOLENCE PREVENTION PROGRAM (PI-06-17)

During a preliminary inquiry, we learned that the Commission has not updated its policy prohibiting workplace violence and has no formal procedures for preventing and addressing potential violence in the workplace.

We recommended that the Office of Human Resources update the policy prohibiting workplace violence. We also recommended that OHR develop formal procedures for preventing and addressing workplace violence, and distribute the updated policies and procedures to Commission staff.

Investigative Program

Nine investigations were closed during the period. Five subjects were referred to the Department of Justice, which declined prosecution of these subjects. Seven subjects were referred to Commission management. Management directed one subject to cease outside employment, while management decided to take no action for another subject. One subject referred during the prior semi-annual period was demoted to a non-supervisory position; another subject referred during the prior period was suspended for five days and required to attend anger management training. Seven subjects referred during this period and the prior semi-annual period are awaiting disposition.

The most significant cases closed during the period are described below.

MISUSE OF COMMISSION IT RESOURCES

An Office investigation developed evidence that a staff member made threatening statements in e-mail messages, exchanged e-mails containing foul and crude language, and possessed and exchanged inappropriate computer files. We also found evidence that the staff member possessed and forwarded to another employee possibly illegal copying software, violated various information technology policies and procedures, and misused

official time by sending personal e-mails during work hours. The Department of Justice declined prosecution, and administrative action is pending.

MISUSE OF OFFICIAL TIME AND RESOURCES

An investigation found evidence that a supervisor misused official time and the official time of subordinates to perform work for a private, non-profit enterprise. Our investigation also disclosed that one of the subordinates was paid by the non-profit enterprise for work performed on official Commission time. We further found evidence that the supervisor and this subordinate misused government computer equipment and resources to support this enterprise. The Department of Justice declined prosecution, and administrative action is pending for both the supervisor and the subordinate.

RECEIPT OF A REFERRAL FEE

The Office investigated allegations that Commission staff members had recommended a particular outside consulting firm to registrants, and that the consulting firm had paid referral fees to staff members. The evidence developed during the investigation failed to substantiate the allegation.

ABUSE OF DISCRETIONARY AUTHORITY

The Office investigated allegations that Commission supervisors had provided favorable treatment to an individual because of his political connections, and that the supervisors had excluded a former staff member from discussions concerning this individual. It was also alleged that the supervisors had tampered with the former staff member's personnel file. The evidence developed during the investigation failed to substantiate the allegations.

CONFLICT OF INTEREST

The Office investigated an allegation that a staff member was engaged in outside employment that appeared to conflict with the staff member's official duties. We found conflicting evidence concerning the ethics advice that had been provided to the staff member. Management has directed the employee to terminate the outside employment.

THREATS

An investigation found evidence that a staff member approached a Commission security guard on Commission premises and made threatening statements, after the two individuals had a previous verbal altercation off Commission property. The Department of Justice declined prosecution, and administrative action is pending.

Significant Problems

No new significant problems were identified during the period.

Significant Problems Identified Previously

FINANCIAL MANAGEMENT SYSTEMS CONTROLS

An OIG contractor completed an audit of Commission financial management systems controls during a prior period (Audit No. 362). The audit found that Commission financial management controls for fiscal year 2002 were effective in all material respects, based on criteria established under the Federal Managers Financial Integrity Act, except for three material weaknesses and one material non-conformance.

The exceptions concerned property accountability, accounting and control of disgorgements, information system and security program controls, and the Disgorgement and Penalties Tracking System. We reported that, taken together, these financial management exceptions were a significant problem for the Commission. Management concurred with our recommendations to strengthen these financial controls, and promptly began to take actions to correct the weaknesses.

The Government Accountability Office (GAO) performed the audit of the Commission's financial statements for fiscal years 2004 and 2005. The audits found that the Commission has made significant progress in building a financial reporting structure for preparing financial statements for audit. GAO also found that the SEC property account balance was below the threshold for materiality; as a consequence we removed property accountability as an element of this significant problem. However, GAO identified material internal control weaknesses in preparing financial statements and related disclosures, recording and reporting disgorgements and penalties, and information security, which is now the basis for this significant problem.

Management intends to complete corrective actions by the end of fiscal year 2006 to address the weaknesses identified by GAO and our office. GAO will review these actions in connection with its audit of the Commission's fiscal year 2006 financial statements.

INFORMATION TECHNOLOGY MANAGEMENT

Since April 1996, we have reported information technology (IT) management as a significant problem based on weaknesses identified by several audits, investigations, and management studies. Significant IT weaknesses of continuing concern include IT capital investment decision-making; information systems security; administration of IT contracts; IT project management; enterprise architecture management; strategic management of IT human capital; and management of software licenses.

During this semi-annual period, the Office of Information Technology (OIT) indicated that it continued to strengthen the management of Commission IT and has made improvements to correct this significant problem. Detailed descriptions of the progress made are included in the Management Response accompanying this report. OIT expects that IT management will no longer be a significant problem by the semi-annual reporting period beginning April 1, 2007.

Although OIT continues to take action to correct the identified IT weaknesses, we still consider IT management to be a significant problem at this time. We intend to continue our oversight of this area.

Access to Information

The Office of Inspector General has received access to all information required to carry out its activities. No reports to the Chairman, concerning refusal of such information, were made during the period.

Other Matters

EXTERNAL COORDINATION

The Office actively participates in the activities of the Executive Council on Integrity and Efficiency (ECIE). The Inspector General attends ECIE meetings, is an active member of its Financial Institutions Regulatory Committee, and serves as the ECIE member on the Integrity Committee (established by Executive Order No. 12993).

The Deputy Inspector General is an active member of the Federal Audit Executive Council (FAEC). The FAEC considers audit issues relevant to the Inspector General community.

The Associate Inspector General for Investigations/Counsel to the Inspector General and the Associate Counsels are active members of the PCIE Council of Counsels. The Council considers legal issues relevant to the Inspector General community.

PEER REVIEW

The Office of Inspector General of the Corporation for Public Broadcasting performed a peer review of the Office's audit function during the period. It has not yet finalized its report.

We expect to make several changes to our Audit Manual as a result of the review to enhance the Office's quality control system for audits.

Questioned Costs

		DOLLAR VALUE (IN THOUSANDS)		
		<u>NUMBER</u>	<u>UNSUPPORTED COSTS</u>	<u>QUESTIONED COSTS</u>
A	For which no management decision has been made by the commencement of the reporting period	0	0	0
B	<i>Which were issued during the reporting period</i>	<u>0</u>	<u>0</u>	<u>0</u>
	Subtotals (A+B)	0	0	0
C	For which a management decision was made during the reporting period	0	0	0
(i)	Dollar value of disallowed costs	0	0	0
(ii)	Dollar value of costs not disallowed	0	0	0
D	For which no management decision has been made by the end of the period	0	0	0
	Reports for which no management decision was made within six months of issuance	0	0	0

Recommendations That Funds Be Put To Better Use

		<u>NUMBER</u>	<u>DOLLAR VALUE (IN THOUSANDS)</u>
A	For which no management decision has been made by the commencement of the reporting period	0	0
B	Which were issued during the reporting period	<u>0</u>	<u>0</u>
	-		
	Subtotals (A+B)	0	0
C	For which a management decision was made during the period	0	0
	(i) Dollar value of recommendations that were agreed to by management	0	0
	- Based on proposed management action	0	0
	- Based on proposed legislative action	0	0
	(ii) Dollar value of recommendations that were not agreed to by management	0	0
D	For which no management decision has been made by the end of the reporting period	0	0
	Reports for which no management decision was made within six months of issuance	0	0

Reports with No Management Decisions

Management decisions have been made on all audit reports issued before the beginning of this reporting period (October 1, 2005).

Revised Management Decisions

No management decisions were revised during the period.

Agreement with Significant Management Decisions

The Office of Inspector General agrees with all significant management decisions regarding audit recommendations.